SUPREME COURT OF THE STATE OF NEW YORK — New York COUNTY
PRESENT: O. PETER SHERWOOD PART 49
Justice

SEEKING VALHALLA TRUST f/k/a CARL DEANE 2013 REVOCABLE TRUST and ABSALOM ABSALOM TRUST f/k/a ANNE DEANE 2013 REVOCABLE TRUST derivatively on behalf of SAINT GERVAIS LLC,

Plaintiffs,

-against-

CAROL DEANE and STARRETT CITY PRESERVATION LLC,

Defendants.

INDEX NO.	653174/2018
MOTION DATE	March 12, 2019
MOTION SEQ. NO.	002
MOTION CAL. NO.	

The following papers, numbered 1 to ___ were read on this motion to dismiss.

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion to dismiss is decided in accordance with the accompanying decision and order.

MOTION/CASE IS RESPECTUFLLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: April 1, 2019

O. PETER SHERWOOD, *J.S.C.*

Check one: ☑ **FINAL DISPOSITION** ☐ **NON-FINAL DISPOSITION**
Check if appropriate: ☐ **DO NOT POST** ☐ **REFERENCE**
☐ **SUBMIT ORDER/ JUDG.** ☐ **SETTLE ORDER/ JUDG.**

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

SEEKING VALHALLA TRUST f/k/a CARL DEANE 2013 REVOCABLE TRUST and ABSALOM ABSALOM TRUST f/k/a ANNE DEANE 2013 REVOCABLE TRUST derivatively on behalf of SAINT GERVAIS LLC,

Plaintiffs,

-against-

CAROL DEANE and STARRETT CITY PRESERVATION LLC,

Defendants.

DECISION AND ORDER
Index No.: 653174/2018

Motion Sequence No.: 002

O. PETER SHERWOOD, J.:

This action arises out of the sale of Starrett City, a massive real estate development in Brooklyn, New York. Defendant Starrett City Preservation LLC (Preservation) held a 19.9% indirect interest in Starrett City. Defendant Carol Deane (Carol) held a 52.4% interest in Preservation and derivative plaintiff Saint Gervais LLC (Saint Gervais) held a 45.1 % interest. Plaintiffs Seeking Valhalla Trust, f/k/a Carl Deane 2013 Revocable Trust and Absalom Absalom Trust f/k/a Anne Deane 2013 Revocable Trust, and Carol, all hold interests in Saint Gervais. Plaintiffs allege that, after the sale of Starrett City, Carol, the Managing Member of Preservation, improperly reallocated Saint Gervais' interest in Preservation from 45.1% to 22.5%, and increased her direct interest in Preservation from 52.4% to 75%. Carol and Preservation now move for dismissal of the complaint.

I. BACKGROUND

Plaintiff trusts are the trusts of Anne Deane (Anne) and Carl Deane (Carl), the natural adult children of Carol and Disque Deane (Disque), Carol's now-deceased husband. Anne and Carl, 29 and 26 years old, respectively, through their trusts, sue their mother, Carol, and Preservation, derivatively on behalf of Saint Gervais, a Delaware company that is largely a Deane family investment entity.

Preservation was established in 2006 by Disque to receive the benefit of a 19.9% economic interest in Starrett City Associates LP (SCA), a limited partnership and beneficial owner of Starrett

City (*id.*, ¶¶ 2, 21). SCA was created and operated by Disque and, after his death, by Carol (*id.*, ¶¶ 23, 26). Starrett City is this country's largest affordable housing development, comprised of 46 buildings containing over 5,000 subsidized residential units housing over 15,000 low and middle-income New Yorkers, and commercial tenants who provide services to Starrett City residents (*id.*, ¶ 20).

The initial members of Preservation were Saint Gervais, Carol, Mary Clarke (Mary), and three members of the management team – Harvey Rudman (Rudman), Harold Kuplesky (Kuplesky) and Martin Fell (*id.*, ¶ 25). Carol has been the Managing Member of Preservation since its inception (*id.*, ¶¶ 2, 25).

The initial purpose of Preservation is set forth in section 1.3 of Preservation's operating agreement (the Preservation Agreement): "to provide its Members with a beneficial interest in all payments payable by [SCA to the Managing General Partner and Salt Kettle, LLC, SCA's General Partner, and by assignment to Preservation], in each case on the terms and conditions, and subject to the limitations, set forth here" (*id.*, ¶ 26).

The terms, conditions and limitations on the right of Preservation members to receive the distributions at issue in this case are found in section 3.3 of the Preservation Agreement, entitled "Reallocation of Sharing Ratios":

> "At any time after the Funding Event (as hereinafter defined), the Managing Member may, in its sole discretion, reallocate the Sharing Ratios of all Members *in whatever amounts it deems in its sole discretion to be appropriate (including, without limitation, assigning a member a Sharing Ratio of zero)*".
>
> "'Funding Event' shall mean the distribution to Members [of Preservation], in accordance with their then current Sharing Ratios (taking in account all prior changes in Sharing Ratios provided for in Article V but before any reallocation pursuant to this Section 3.3), of at least $10,000,000 in aggregate distributions pursuant to Section 4.2 (iv)"

(Preservation Agreement, § 3.3 [emphasis added]). Here, the "Funding Event" required by section 3.3 before there could be any change of reallocation of sharing ratios occurred in 2010, following a refinancing of Starrett City (complaint, ¶ 36).

Carol is also a member and the Operating Manager of Saint Gervais (complaint, ¶ 17). The affairs of Saint Gervais are controlled by Carol and two managers, Mary (Carol's sister and the mother of two additional Saint Gervais members), and Curt Deane (Curt, Disque's nephew) (*id.*,

¶¶ 18, 25). Mary owns 2.16% of Saint Gervais, Curt owns .87% of Saint Gervais, and Mary's children, Christopher and Jonathan Clarke, each own .87% of Saint Gervais, in addition to other minority interests (*id.*).

At the time it was formed, Saint Gervais had a 45.1% interest in Preservation and Carol had a 14.3% interest, but after refinancing, Carol caused certain members' stakes in Preservation to be reallocated to herself, making her a 52.4% owner in Preservation (*id.*, ¶¶ 25-39). Through their personal trusts, Anne and Carl each own a 35.96% membership interest in Saint Gervais (*id.*, ¶¶ 2, 11-12), but have no control over management (*id.*, ¶ 25).

On May 7, 2018, Carol, who has been in charge of running Starrett City since the death of her husband in November 2010 (*id.*, ¶ 23), closed on the sale of Starrett City (and a related shopping center entity) (*id.*, ¶ 3). Around this time, Anne wrote an email to her mother demanding that she step down as Operating Manger of Saint Gervais, and requesting certain books and records from Saint Gervais (*id.*, ¶¶ 44-45).

On May 24, 2018, Preservation received a total of $85,570,000 in distributions from SCA reflecting its share of the proceeds from the sale of Starrett City (*id.*, ¶ 49).

The same day, Carol sent an email to Anne and Carl claiming that "on May 16, 2018, in the exercise of my discretion as Managing Member of [Preservation] and pursuant to Section 3.3 of the Preservation LLC Agreement, I reduced [Saint Gervais'] sharing ratio in Preservation from 45.1% to 22.5%, a reduction of approximately 50%" (*id.*, ¶ 50).

Plaintiffs do not dispute that Carol, as Managing Member of Preservation, has the right to alter the sharing ratios, but contend that Carol has improperly altered those shares on a retroactive basis after the date by which the money was earned (*id.*, ¶ 5). Carol now claims to have a 75% direct interest in Preservation and the profits it received from the sale of Starrett City (*id.*, ¶ 51).

Section 4.2 of the Preservation Agreement deals with the disposition of all "payments received" by Preservation:

> "[P]ayments received [by Preservation] shall be distributed and applied by [Preservation] in the following order and priority": (I) to the payment of accrued expenses; (ii) to the payment of debts and liabilities; (iii) to the payment of bonus awards to office staff up to a maximum of ten (10%) percent of all payments; (iv) to repay the Members' capital contributions; (v) to the members to the extent of their positive Capital Account; and (vi) "the balance, to the Members in proportion to their Sharing Ratios"

(Preservation Agreement, § 4.2). These distributions are to be made "as soon as practicable but at least in the same calendar year in which Payments are received by [Preservation]" (*id.*).

The complaint contains four causes of action. The first cause of action seeks a declaratory judgment that Saint Gervais is the rightful owner of 45.1% of Preservation's interest in the proceeds of the recent sale of Starrett City, along with an order directing Carol and Preservation to transfer those funds to Saint Gervais. The second cause of action is a breach of fiduciary duty claim against Carol on behalf of Saint Gervais for allegedly "engaging in a self-interested transaction," i.e., the reduction of Saint Gervais' interest by half, and the reallocation of that reduction to herself. The third cause of action seeks an accounting. The fourth cause of action seeks an order compelling the production of Preservation's books and records.

Plaintiffs sought a preliminary injunction enjoining defendants from (1) "distributing, disposing or otherwise transferring any of the proceeds received by SCA on or about May 24, 2018, directly or indirectly, from the sale of Starrett City," and (2) "purporting to retroactively reallocate [Saint Gervais'] sharing ratio in" SCA. On August 7, 2018, this court denied plaintiffs' motion for a preliminary injunction for failure to establish irreparable harm.

II. PARTIES' CONTENTIONS

A. Demand Futility

Under Delaware law, which controls because Saint Gervais is a Delaware LLC, "as a condition precedent to a plaintiff bringing a shareholder derivative action on behalf of a corporation, the plaintiff must make a pre-suit demand that the board pursue the contemplated action" (*Asbestos Workers Phila. Pension Fund v Bell*, 137 AD3d 680, 681-682 [1st Dept 2016]). "A pre-suit demand upon a board may be excused, however, if such a demand would have been 'futile'" (*id.* at 682; *Otto v Otto*, 110 AD3d 620, 621 [1st Dept 2013] ["(b)oth New York and Delaware law require a plaintiff to bring a derivative action on behalf of a limited liability company . . . to plead that demand was made or that demand was futile"]).

To demonstrate futility under Delaware law, the complaint must contain "particularized factual allegations . . . [that] create a reasonable doubt that, at the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand" (*Rales v Blasband*, 634 A2d 927, 934 [Del 1993]; Delaware Chancery Court Rule 23.1 [in a derivative action, the complaint must "allege with particularity the

efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort"]; *see also Asbestos Workers Phila. Pension Fund*, 137 AD3d at 684 [observing that a "lack of oversight" claim to excuse demand is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment"] [internal quotation mark and citation omitted]). "The key principle upon which this area of our jurisprudence is based is that the directors are entitled to a *presumption* that they were faithful to their fiduciary duties" (*Beam ex rel Martha Steward Living Omnimedia, Inc. v Stewart*, 845 A2d 1040, 1048 [Del 2004]). In order "[t]o rebut the presumption of disinterestedness, the plaintiff must plead particularized facts that, if proved, would establish that a majority of the directors face a 'substantial likelihood' of personal liability for the wrongdoing alleged in the complaint" (*Wandel v Dimon*, 135 AD3d 515, 517 [1st Dept 2016] [citation omitted]). "A director is considered interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders" (*Rales*, 634 A2d at 936).

Defendants contend the complaint must be dismissed on the ground that plaintiffs lack standing to sue derivatively on behalf of Saint Gervais. Defendants also argue that plaintiffs failed to demand of the Saint Gervais managers that Saint Gervais bring this action, and fail to adequately allege in the complaint that a demand would have been futile.

Although plaintiffs allege it "would be futile" for plaintiff to demand that "the managers of [Saint Gervais] (one of which is Carol) or Carol, as its Operating Manager, initiate this action in the name of the company itself, as Carol is directly interested in the underlying issues and is the person who is alleged herein to have engaged in illegal and wrongful conduct on behalf of herself individually and on behalf of Preservation" (complaint, ¶ 18), defendants argue this conclusory futility claim is inadequate to justify plaintiff's failure to make a demand on Saint Gervais' managers.

Defendants further contend that, according to Saint Gervais' operating agreement, the decision whether to "commence, prosecute or defend any proceeding" on behalf of Saint Gervais is generally to be left to the Operating Manager, *i.e,* Carol (Operating Agreement, § 7.2). But where, as here, litigation action or inaction proposed by the Operating Manager "could result in a change in the amount or character of [Saint Gervais'] capital," the Operating Manager's proposal

requires "the prior written consent of a majority of the Managers including the consent of the Operating Manager" (*see id.* at § 7.3). Thus, the Operating Manager is permitted to vote in support of her decision, but the other managers can outvote her. Defendants argue that Carol is only one of three Saint Gervais managers, and if plaintiffs had demanded Saint Gervais initiate this action and Carol refused, the other two managers (Mary and Curt) had the power to overrule her.

In opposition to the motion, plaintiffs contend that § 7.3 of Saint Gervais' Operating Agreement does not require a majority vote of managers on a decision to litigate, and does not give the other managers the power to overrule Carol; rather it only requires Carol's consent and the consent of at least one other manager (opp mem at 12). Plaintiffs further argue that, even if the other managers could overrule Carol, demand is still futile because, since Mary and Curt are part of Carol's family, they are incapable of independence (*id.* at 10, citing *Grimes v Donald*, 673 A2d 1207, 1216 [Del 1996], *overruled on other grounds by Brehm v Eisner*, 746 A2d 144 [Del 2000] [where other directors are related to the conflicted director, demand is found to be futile]; *see also Harbor Fin. Partners v Huizenga*, 751 A2d 879, 889 [Del Ch 1999]). Finally, plaintiffs contend that, contrary to defendants' position, they have "certainly pled 'particularized factual allegations' that a demand upon Carol (or even Curt, or May, although not necessary) would have been futile" (*id.* at 13)

The complaint must be dismissed on the ground that plaintiffs have failed to establish standing to sue derivatively on behalf of Saint Gervais. Because Saint Gervais' managers are empowered to manage, or direct the management of, the business and affairs of Saint Gervais, plaintiff may prosecute this derivative suit in the name of Saint Gervais only upon a showing that such demand would have been futile because a majority of Saint Gervais' managers were incapable of making an impartial decision regarding the contemplated litigation. The complaint falls far short of meeting the heightened pleading standard under Delaware law, including Delaware Chancery Court Rule 23.1(a) before a derivative action like this one can be brought. Under Delaware law, plaintiffs were required to plead "particularized factual allegations" in their complaint establishing futility, which they have failed to do here (*see e.g. Glaubach v PriceWaterhouseCoopers, LLP*, 2018 NY Slip Op 30875[U], *4 [Sup Ct, NY County 2018] [dismissing all derivative claims because, *inter alia*, the complaint failed to allege "particular facts

establishing that a majority of the board at the time plaintiffs commenced the action was interested or lacked independence" or "faced a substantial likelihood of liability"]).

First, the complaint contains only conclusory allegations that demand is futile because Carol is not disinterested. Moreover, the complaint fails to allege that managers Mary or Curt, plaintiffs' maternal aunt and paternal cousin, would have been incapable of exercising independent and disinterested business judgment in responding to a demand for litigation by plaintiffs, or that they would have been incapable of making a fair and considered decision on plaintiffs' demand. Indeed, Mary is not only a member of Saint Gervais but the mother of two of Saint Gervais' members, and all three of them are adversely affected by the reduction of Saint Gervais' sharing ratio in Preservation. The complaint also fails to allege that Mary or Curt faced a "substantial likelihood" of personal liability for Carol's alleged wrongdoing which would prevent them from making a disinterested determination in response to a demand.

Plaintiffs attempt to cure this defect by alleging in the opposition memorandum that Mary and Curt "are incapable of independence" because both "are part of Carol's family" and "were employed by Carol at the time this action was commenced (opp mem at 12-13). However, plaintiffs cannot amend their complaint through their opposition memorandum of law (*see Hall v Coupe*, 2016 WL 3094406, *3, n 20 [Del Ch 2016]; *Metropolitan Life Ins. Co. v Tremont Group Holdings, Inc.*, 2012 WL 6632681, * 16 [Del Ch 2012] ["a party cannot use its brief as a mechanism to informally amend its complaint"]; *see also MediaXposure Ltd. (Cayman) v Omnireliant Holdings, Inc.*, 29 Misc 3d 1215[A], 2010 NY Slip 51835[U]. *6 [Sup Ct, NY County 2010] [denying plaintiff's attempt to "amend the complaint through an opposition brief, which is not permissible]"). In any event, these allegations are insufficient as a matter of law to rebut the presumption of disinteredness accorded to Mary and Curt under Delaware law.

There is no merit to plaintiffs' argument that only Carol could decide whether to permit derivative litigation because section 7.3 of Saint Gervais' Operating Agreement does not require a majority vote of managers on a decision to litigation. By its explicit terms, section 7.3 governs any "act taken, sum expended, *decision made*, obligation incurred or *power exercised*" with respect to any "any matter which could result in a change in the amount or character of the Company's capital" (Operating Agreement, § 7.3 [emphasis added]). This language clearly covers the instant action, which seeks to nullify the reduction of Saint Gervais' sharing ratio.

Plaintiff's alternative argument that section 7.3 does not give the other managers the power to overrule Carol is also without merit. Section 7.3 voting requires the "prior written consent of a majority of the Managers *including the consent of the Operating Manager*" (*id.* [emphasis added]). A plain reading of this section means that an action or decision proposed by the Operating Manager may only be implemented with the consent of a majority of the Managers. Since Saint Gervais has three Managers, including Carol, this means that on matters governed by section 7.3, the Operating Manager must obtain the consent of at least one of the other two Managers. If the other two Managers disagree with her proposed action or decision, she would be outvoted. Had plaintiffs made a demand on Saint Gervais to bring this lawsuit and Carol opposed the demand, she would have needed the backing of either Curt or Mary.

Because plaintiffs have failed to make the required "particularized factual allegations" that a majority of Saint Gervais' managers could not properly function in their appointed roles, the complaint must be dismissed for lack of standing. However, even if the court were to allow standing, the case must be dismissed.

B. Failure to State a Cause of Action

1. Declaratory Judgment (First Cause of Action)

Plaintiff's first cause of action seeks "a declaratory judgment establishing that [Saint Gervais] is the rightful owner of 45.1% of Preservation's interest in the proceeds of the sale of Starrett City, and an order directing [Carol] and Preservation to transfer those funds to [Saint Gervais]" (complaint, ¶ 68). Plaintiffs' position is that Carol's reduction of Saint Gervais' sharing ratio on May 16 was ineffective because, in their view, on May 7, 2018, Saint Gervais "earned" its share of the funds received by SCA, and any subsequent reduction of Saint Gervais' sharing ratio by Carol was by definition "retroactive," and therefore impermissible. In other words, upon the sale of Starrett City in May 2018, Carol was stripped of the discretion, given to her by the Preservation Agreement, to reduce any member's sharing ratio in Starrett City proceeds received or to be received by Preservation.

In the complaint, plaintiff alleges that Carol was only permitted to reallocate sharing ratios "in order to incentivize the Management Team," or for some other legitimate business reasons (*id.*, ¶ 35). In making this allegation, plaintiff cites to the last sentence of section 3.3 of the Preservation Agreement, which provides that:

> "All Members acknowledge and agree that the Managing Member's reallocation power pursuant to this Section 3.3 is intended to facilitate providing a new management incentive program after full distribution of proceeds of a substantial refinancing pursuant to Section 3.02 or Section 3.03 of [the Partnership's] partnership agreement."

Defendants contend that this argument disregards the plain language of sections 3.3 and 4.2 of the Preservation Agreement. Under these sections, a Preservation member's "entitlement" to a share of the Starrett City sale proceeds does not even arguably begin to exist until after Preservation receives those funds. Section 4.2, which addresses "Distributions," contemplates the distribution of proceeds to members only on Preservation's receipt of funds: "All payments *received* from the MGP, KSKI or any successor transferee ('Payments') shall be distributed and applied by [Preservation] in the following order and priority" (Preservation Agreement, § 4.2 [emphasis added]) Defendants argue that Preservation did not receive its share of the sale proceeds until more than one week after Carol reduced Saint Gervais' sharing ratio on May 16, 2018. Thus, Saint Gervais had no "entitlement" to share in the Starrett City sale proceeds at the time that Carol reduced Saint Gervais' share ratio.

Defendants further argue that sections 1.3 and 3.3 of the Preservation Agreement are also fatal to plaintiff's position. Section 1.3 explicitly states that the right of members to a "beneficial interest in all payments payable" by SCA to the MGP and Salt Kettle is "in each case" subject to "the terms and conditions, and . . . . the limitations set forth [in the Preservation Agreement]." Defendants argue that, in other words, even if funds are "earned" by Preservation's members prior to Preservation actually receiving those funds, as plaintiffs contend, a member's beneficial interest in those funds is still subject to "conditions" and "limitations," including the Managing Member's complete discretion under section 3.3 to reduce any member's sharing ratio "at any time" and in "whatever amounts" the Managing Member determines in her "sole discretion" following the Funding Event that occurred in 2010.

Defendants argue that, thus, the plain language of the Preservation Agreement explicitly refutes plaintiffs' argument that Saint Gervais is "entitled" to maintain a 45.1% sharing ratio in the Starrett City sale proceeds Preservation received in May 4, 2018, eight days after the sharing ratio reduction by Carol.

Defendants further argue that both *Rudman v Deane* (138 AD3d 537 [1st Dept 2016]) and *Sullivan v Harnisch* (96 AD3d 667 [1st Dept 2012]) support their interpretation of the Preservation Agreement, i.e., that following the triggering event in the Preservation Agreement, the occurrence of a "Funding Event" in 2010, Carol, as Managing Member of Preservation, has had the "sole discretion" to reduce the sharing ratios of "all Members" "at any time," even to zero, and the sale of Starrett City did not terminate her discretion.

Rudman concerned the same operating agreement at issue here – the Preservation Agreement. In that case, following a substantial refinancing of SCA, which occurred on December 17, 2009, SCA distributed approximately $38 million to Preservation. Preservation distributed $32 million of that amount to its members, including 15.01% to Rudman and 3.489% to Kuplesky, both former members of Preservation's management team. On November 10, 2010, the date Disque died, Carol reduced Rudman and Kuplesky's interest to zero. Rudman and Kuplesky sought a declaration that section 3.3 could not be used to reduce their shares to zero until they received certain equity interests in SCA, and a share of charitable deductions that SCA could claim. The First Department held that Carol, as Managing Member "has to power to reallocate the Sharing Ratios of any Member once . . . Preservation has distributed to its Members, in accordance with Section 4.2, at least $10 million" (*Rudman*, 138 AD3d at 538). As a result, because more than $10 million was distributed to Preservation's members, Carol's powers under section 3.3 were triggered (*id.*).

Defendants contend that the court in *Rudman* held that "a member of Preservation is never entitled to any particular distribution or sharing ratio prior to actual distribution because the Managing Member can change that member's sharing ratio 'at any time,' even to zero, until the distribution occurs" (defendants' memorandum at 13). Defendants argue that, applying *Rudman* here, Carol was "unquestionably entitled to reduce Saint Gervais' sharing ratio even after SCA has distributed to Preservation its share of the proceeds from the sale of Starrett City."

Defendants also rely on *Sullivan*. In that case, as here, the operating agreement gave the LLC manager the authority to determine "from time to time" the plaintiff's sharing ratio in bonus pools pursuant to two LLC agreements. After an end-of-the-year reduction in his sharing ratios, plaintiff sued over the defendant's "retroactive" reductions in his sharing ratios on various grounds, including breach of fiduciary duty. The First Department reversed the lower court and

dismissed the plaintiff's complaint because the LLC agreements unambiguously authorized the defendant to determine sharing ratios in his "sole discretion" and whenever he wanted to. The Court held that the defendant's "sole discretion" meant that he could reduce the plaintiff's sharing ratios for any reason, even "impetuously" or "whimsically" (*Sullivan*, 96 AD3d at 668). According to defendants, this case squarely rejects plaintiffs' contention that the Managing Member could only reduce a sharing ratio for a "legitimate business purpose."

Defendants contend that, pursuant to both *Rudman* and *Sullivan*, Carol was thus unquestionably entitled to reduce Saint Gervais' sharing ratio even after SCA has distributed to Preservation its share of the proceeds from the sale of Starrett City.

Finally, defendants argue that there is no basis for plaintiffs' argument related to the last sentence of § 3.3, that Carol can only reallocate sharing ratios in order to incentivize the management team or for some other legitimate business reason, because that sentence is an inoperative statement of intent with no force and effect.

In opposition to the motion, plaintiffs contend that, while there is no dispute that Carol has the right to alter the sharing ratio of Preservation's members in order to incentivize management following a refinancing pursuant to section 3.3 of the Preservation Agreement, Carol has no right to retroactively alter a Member's share of profits and proceeds once that money was earned – i.e., on May 7, 2018, the date on which the sale of Starrett City closed. Pursuant to section 1.3 of the Preservation Agreement, the purpose of Preservation is to "provide its Members with a beneficial interest in all payments payable by SCA . . . to the [General Partners], in respect of [the General Partners'] economic interest in SCA." Plaintiffs argue that since Preservation's purpose was to serve as a conduit, directing the distribution SCA was required to make to the general partners of Preservation, Preservation has economic interests in all amounts "payable" to the general partners, and Preservation's economic interest in the proceeds of the sale of Starrett City was "payable" the moment the sale of Starrett City closed, which was May 7, 2018.

Plaintiffs also argue that defendants may not rely on *Rudman* because this court, in its decision on the preliminary injunction motion, specifically held that *Rudman* does not "defeat[] plaintiffs' claim for a declaratory judgment [as it] does not hold that Carol may make those reallocations with retroactive effect, after plaintiffs' have become entitled to payment" (preliminary injunction decision at 6).

Plaintiffs further argue that *Sullivan* is distinguishable because the First Department only analyzed whether the bonus pool could be reallocated, not the membership pool.

Finally, plaintiffs argue that Carol's "sole discretion" to reallocate sharing ratios under section 3.3 is constrained by the express intent of section 3.3, as set forth in the last sentence, which "makes clear that Carol could not reallocate [Saint Gervais'] sharing ratio at her 'whimsy'" (plaintiffs' mem at 18).

Under the plain language of the Preservation Agreement, the first cause of action must be dismissed. "It is well settled that a written agreement which is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms" (*Masters v 14-22 Leonard St. Assoc. LLC*, 11 AD3d 380, 381-382 [1st Dept 2004], citing *Vermont Teddy Bear Co. v 538 Madison Realty Co.*, 1 NY3d 470, 475 [2004]). Plaintiffs' claim that Carol's reduction of Saint Gervais' sharing ratio on May 16, 2018 was ineffective because Saint Gervais "earned" its share of the funds received by SCA is belied by the plain meaning of section 3.3 of the Preservation Agreement, which authorizes the Managing Member to reallocate the sharing ratios of "all members" "at any time," in her "sole discretion" and in any amount, prior to distribution to Preservation members.

As of May 7, none of the sale proceeds SCA received in the Starrett City transaction were owed or payable to Saint Gervais by SCA or by Preservation. Indeed, according to section 4.2 of the Preservation Agreement, a member is not eligible to receive any of the sale proceeds until after Preservation has received the proceeds from SCA, which did not happen until May 24, eight days after Carol reduced Saint Gervais' sharing ratio, and then only after Preservation pays other expenses, including bonuses and debts. Thus, as of May 7, plaintiffs had not "earned" any payment or distribution from either SCA or Preservation of any of the Starrett City proceeds. At that point, Preservation's members, including Saint Gervais, may have had an expectation, but had no assurance that they would receive their sharing ratios, which were subject to the "terms," "conditions" and "limitations" of the Preservation Agreement (*see* § 1.3), the most relevant of which is found in section 3.3. As described above, § 3.3 entitles the Managing Member to reallocate sharing ratios "at any time" in "whatever amounts" she "deems in her sole discretion" to "be appropriate (including without limitation, assigning a Member a Sharing Ratio of zero)'.

Rudman does not support defendants' interpretation of section 3.3. However, defendants' interpretation is supported by the First Department's decision in *Sullivan*, which held that a member's sharing ratio could be reduced by the manager of the LLC even after the end of the year in which the money was purportedly "earned" by the member. Plaintiffs' attempt to distinguish *Sullivan* on the ground that the Court was analyzing a "bonus pool" rather than a "membership pool" is unpersuasive. The relevant point is that the agreement in *Sullivan*, like the agreement here, permitted reallocations from "time to time", and subject only to the "sole discretion" of the manager.

Moreover, plaintiffs' argument that Carol's "sole discretion" is limited by the last section of section 3.3 lacks merit, as a plain reading of that sentence reveals that it is merely a statement of intention (*see Rudman*, 138 AD3d at 539 [finding this sentence to be "a statement of intention; it does not actually require the full distribution of proceeds"]). Plaintiffs have failed to cite any authority for their interpretation of the Preservation Agreement.

The plain language of the Preservation Agreement compels dismissal of plaintiffs' first cause of action.

2. Breach of Fiduciary Duty (Second Cause of Action)

Plaintiffs contend that Carol's discretion to reallocate sharing ratios is limited by section 7.5 of the Preservation Agreement, which provides that "[t]he Managing Member . . . shall discharge [her] duties as a manager in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner that they reasonably believe to be in the best interests of the Company." In the second cause of action, plaintiffs allege that "[b]y reducing [Saint Gervais'] sharing ratio in Preservation, and, in turn, purporting to reduce [Saint Gervais'] indirect interest in Preservation's net income from the sale of Starrett City, while simultaneously increasing her interest in the same, Carol failed to exercise the care required, and breached her duties of loyalty, good faith, candor and independence owed to [Saint Gervais]" (complaint, ¶ 72).

Defendants argue that section 7.5 does not limit the Managing Member's "sole discretion" conferred on her by section 3.3 because section 7.5 only governs the exercise of the Managing Member's duties ("The Managing Member . . . shall discharge their duties as managers in good faith"]). According to defendants, Carol's authority under section 3.3 is not a "duty" but a right

she is empowered to exercise. Defendants also argue that the duties imposed by section 7.5 are not unique to Preservation. New York law imposes the same duties on all LLC managers (*see* NY LLC Law § 409 ["A manager shall perform his or her duties as a manager, including his or her duties as a member of any class of managers, in good faith and with degree of care that an ordinarily prudent person in a like position would use under similar circumstances"]). Finally, defendants argue that the breach of fiduciary cause of action fails, because, under New York law, it cannot be used to negate an express provision of an agreement.

In opposition to the motion, plaintiffs contend that Carol is required to exercise her duties in good faith pursuant to section 7.5 of the Preservation Agreement, which makes clear that Carol cannot reallocate sharing ratios at her "whimsy"; she must have a legitimate business purpose to do so. As the managing member of Preservation, Carol owed Saint Gervais the duties of loyalty and care, which permeate the entirety of the Preservation Agreement (plaintiffs' opposition at 21, citing LLC Law § 409; *Pokoik v Pokoik*, 115 AD3d 428, 429 [1st Dept 2014]). Plaintiffs further argue Carol is also required to exercise her duties in good faith under § 409 of the LLC law. According to plaintiffs, where a managing member has broad authority to exercise rights under an operating agreement, those rights are circumscribed by the limitations of LLC § 409. Finally, citing *Richbell Info. Servs., Inc. v Jupiter Partners* (309 AD2d 288, 302-303 [1st Dept 2003]), plaintiff argues that, even where a party has a clear contractual right, that right may not be exercised for personal gain. In *Richbell*, the First Department recognized an inherent limitation on the exercise of contract right, i.e., when "bad faith targeted malevolence in the guise of business dealings" exists. Plaintiff asserts that Carol, in exercising her "sole discretion," acted in a purely malevolent manner for her own personal gain, and thus, under the standard set forth in *Richbell*, the breach of fiduciary duty claim is viable.

Plaintiffs argue that Carol breached her fiduciary duty to Saint Gervais in reducing its sharing ratio in Preservation because she had no legitimate business purpose for the reduction. However, plaintiffs offer no support for the proposition that a "legitimate business purpose" is necessary for the Managing Member to act. Neither New York's LLC statute, nor the Preservation Agreement impose such an obligation. To the contrary, the Preservation Agreement makes clear that the reduction of a member's sharing ratio is a matter entrusted to Carol's sole, broad and complete discretion, whether or not she has a "legitimate business purpose." As a result, there is

no breach of fiduciary duty because, under New York law, such a breach requires the violation of a legal duty separate and apart from, and independent of, the contract or agreement. That duty "must spring from circumstances extraneous to, and not constituting elements of, the contract, although it may be connected with and dependent upon the contract" (*Clark-Fitzpatrick, Inc. v Long Island Railroad Co.*, 70 NY2d 382, 389 [1987]).

Plaintiffs have not alleged that Carol owes Saint Gervais any legal duties other than those existing under the Preservation Agreement. The relationship between the parties was created and is governed by the Preservation Agreement (*see e.g. Panattoni Dev. Co, Inc. v Scott Sund 1-A, LP*, 154 AD3d 555, 558 [1st Dept 2017] [finding no fiduciary duty independent of the parties' contractual duties because defendant "is not suing plaintiff *qua* professional investment advisor; rather [defendant] is suing [plaintiff] as managing member of [the LLC], a relationship that was created by the parties' contract (the LLC agreement)"]).

Indeed, courts frequently dismiss breach of fiduciary duty claims based on facts like those alleged here. For instance, in *Transit Funding Assoc., LLC v Capital One Equip. Fin. Corp* (149 AD3d 23 [1st Dept 2017]), the court found that:

> "Although '[i]n New York all contracts imply a covenant of good faith and fair dealing in the course of performance,' the existence of the covenant cannot be relied on as grounds for TFA's action. The covenant of good faith an fair dealing cannot negate express provisions of the agreement, nor is it violated where the contract terms unambiguously afford Capital One the right to exercise its absolute discretion to withhold the necessary approval. Where a contract allows one party to terminate the contract in 'its sole discretion' and for 'any reason whatsoever,' the covenant of good faith and fair dealing cannot serve to negate that provision"

(*id.* at 29 [citations omitted]). Likewise, in *Hudson Val. Bank, N.A. v BanxCorp.* (28 Misc 3d 1232[A], 2010 NY Slip Op 51572[U] [Sup Ct, Westchester County 2010]), the court dismissed breach of fiduciary duty counterclaims based on its determination that plaintiff's action in "using leverage to force Defendants to agree to more onerous terms, including a higher interest rate, more fees, and a more stringent underwriting process" by threatening to terminate financing did not constitute a breach of fiduciary duties, because the:

> "implied covenant of good faith and fair dealing may not [be] invoked to imply an obligation inconsistent with other terms of the contract between the parties. Since the Agreement gave Plaintiff the right to terminate its financing at any time in its sole discretion, the Court cannot re-write the Agreement in order to create an obligation on the part of Plaintiff to continue providing financing at all, or under the original terms of the Agreement, indefinitely"

(*id.* at *11).

Here, the Preservation Agreement requires dismissal of the second cause of action because it confers on Carol complete discretion to act as she did. Saint Gervais' sharing ratio was subject to reduction and reallocation by Carol "at any time" before a distribution to members takes place. Plaintiffs cannot point to any basis in either the Preservation Agreement or in case law to support their argument for fiduciary breach.

Richbell is inapposite because the conduct there included fraud, collusion and illegality. None of that conduct is alleged here. Here, Carol's conduct, which is fully in compliance with the terms of the Preservation Agreement, cannot be construed as "bad faith targeted malevolence."

Accordingly, defendant is entitled to dismissal of the breach of fiduciary duty claim (*see e.g. Sullivan*, 96 AD3d at 668 ["(p)laintiff's breach of fiduciary duty claim should have been dismissed, since plaintiff has not even alleged a duty separate and apart from defendants' duties under the terms of the operating agreements"]; *Lync Loft, LLC v Hudson Opportunity Fund I, LLC*, 2012 WL 5461371, *12-13 [Sup Ct, NY County 2012] [no breach of fiduciary duty where defendants' duties as LLC managers arose from the parties' contractual relationship]).

3. Accounting and Access to Books and Records (Third and Fourth Causes of Action)

In the third cause of action, plaintiffs seek an accounting, contending that "[b]ecause Carol and Preservation have exclusive control of the books and records of Preservation, [Saint Gervais] is entitled to an accounting of all funds received and/or disbursed by Carol and/or Preservation" (complaint, ¶ 81). In the fourth cause of action, plaintiffs seek access to Preservation's books and records, including "tax returns and reports, financial statements (and supporting documentation), balance sheets, receivables, payables, cash flow statements, and other financial records demonstrating the assets and liabilities of Preservation" for the last three fiscal years, "to ascertain the financial condition of Preservation" (*id.*, ¶ 90). According to the complaint, in "mid-May 2018,

Anne and Carl sought to obtain from Carol the books and records of Preservation" and "Carol has refused to produce such records" (complaint, ¶ 86).

Defendants argue that both causes of action must be dismissed because plaintiffs make no allegation that Saint Gervais, on whose behalf they sue, does not have the records sought, nor do they allege that Saint Gervais does not have sufficient records for plaintiffs' purpose (*see* Preservation Agreement, § 2.3 [Preservation's accountants shall "prepare and provide to Members" reports concerning Preservation's financial conditions and results). Instead, the complaint alleges that Anne and Carl, neither of whom are members of Preservation, made a demand on Carol for Preservation's records. Since Anne and Carl are not members of Preservation, and neither are their trusts, Carol had no obligation to provide them with any records (*see* NY LLC Law § 1102 [b] ["A member may . . . inspect and copy"]).

In opposition to the motion, plaintiffs argue that Saint Gervais is entitled to an order compelling Preservation to produce Preservation's books and records, because they need to ascertain the financial condition of Preservation, which directly impacts the distribution to Saint Gervais.

Both of these causes of action must be dismissed. No demand has been made for Preservation's records by Saint Gervais, the only relevant member of Preservation entitled to make such a demand. Whatever demand for documents was made by Anne or Carl, individually, is irrelevant because neither of them is a member of Preservation or a manager of Saint Gervais. Thus, they had no legal standing to make any demand for Preservation documents or to have their demand honored. Accordingly, the lack of production of documents does not support the need for an accounting.

Accordingly, it is hereby

ORDERED that the motion to dismiss (motion sequence number 002) is GRANTED and the complaint is DISMISSED in its entity; and it is further

ORDERED that judgment be entered against plaintiffs SEEKING VALHALLA TRUST f/k/a CARL DEANE 2013 REVOCABLE TRUST and ABSALOM ABSALOM TRUST f/k/a ANNE DEANE 2013 REVOCABLE TRUST derivatively on behalf of SAINT GERVAIS LLC

and in favor of defendants CAROL DEANE and STARRETT CITY PRESERVATION LLC, together with costs as taxed by the Clerk of the Court upon submission of a proper bill of costs.

This constitutes the decision and order of the court.

DATED: April 1, 2019

ENTER,

O. PETER SHERWOOD J.S.C.